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6 IN THE UNITED STATES DISTRICT COURT
7 FOR THE DISTRICT OF ARIZONA

8
9 Carl Anderson, et al.,

No. CV-11-01175-PHX-DGC

10 Plaintiffs,
v.

ORDER

11 Gregory K. McGrath, et al.,

12 Defendants.

13 On June 8, 2012, a group of 117 investors in D8 2010 Inc., fka Domin-8
14 Enterprise Solutions, Inc., and its predecessor limited liability company, D8 2010, LLC,
15 fka Domin-8 Enterprise Solutions, LLC (“Domin-8” or “the company”), filed their
16 Second Amended Complaint (“SAC” or “the complaint”) against ten of the company’s
17 former officers, four individuals who allegedly sold securities for the company, and five
18 corporate entities. Doc. 98. On June 29, 2012, Defendant Gregory K. McGrath,
19 Defendant Lawrence Labine, and a group of Director and Officer Defendants¹ (“D&O
20 Defendants”) filed separate motions to dismiss. Docs. 101, 103, 105. The motions have
21 been fully briefed. Docs. 112, 113, 114, 124, 126, 127, 128, 130. For the reasons stated
22 below the Court will grant Defendants McGrath, Labine, and Ensign’s motions in full,
23 and grant the D&O Defendant’s motion in part.²

24
25 ¹ Officers: John A. Ensign, Daniel P. Buettin, Thomas Thistleton; Directors: Sean
26 D. Curran, Charles V. Shamblee III, Chris A. Lewis, Ronald J. Rapp, Jay Hill, and Robert
Routt.

27 ² The request for oral argument is denied because the issues have been fully
28 briefed and oral argument will not aid the Court’s decision. *See Fed. R. Civ. P. 78(b);*
Partridge v. Reich, 141 F.3d 920, 926 (9th Cir. 1998).

1 **I. Background.**

2 Domin-8 is a software company that provides software solutions and related
 3 services to the property management industry in the United States and Canada. Doc. 98,
 4 ¶ 118. The history of Domin-8's security offerings, acquisition strategy, and eventual
 5 bankruptcy are chronicled at great length in the SAC. Doc. 98 at 42-134. Suffice it to
 6 say that Domin-8 raised tens of millions of dollars through securities offerings, employed
 7 an aggressive acquisition strategy, operated at a loss, and, on September 17, 2009, filed
 8 for Chapter 11 bankruptcy. Doc. 98, ¶¶ 118, 121, 141-55, 298, 301-02, 328-330, 332-33,
 9 343, 346-47, 359, 361, 366, 377, 402. After filing for bankruptcy, Plaintiffs allege that
 10 entities established by DeWaay Financial and Defendant Lawrence Labine attempted to
 11 purchase Domin-8, but their bid was rejected by the Bankruptcy Court. Doc. 98, ¶¶ 845-
 12 63. Plaintiffs claim that “[a]s a consequence of the calculated bankruptcy filing and
 13 failed attempt to sell Domin-8’s assets . . . , the Investors lost all or a substantial portion
 14 of their investment in Domin-8.” Doc. 98 ¶ 864.

15 Plaintiffs allege violations of federal securities laws and breaches of state law
 16 fiduciary duties. Claims I-X and XII allege violations of Section 10(b) and Rule 10b-5 of
 17 the Securities Exchange Act of 1934, claims XI and XIII allege violations of Section 20
 18 of the Securities Exchange Act of 1934, and claim XIV alleges violations of Section
 19 14(e). Doc. 98 ¶¶ 865-1216. Plaintiffs claim that Directors, Officers, and others who
 20 sold securities in Domin-8 misled investors by failing to disclose material information
 21 and by continuing to sell securities after Domin-8 began contemplating bankruptcy. *Id.*
 22 Against the members of the Board who did not make public statements or sell securities,
 23 Plaintiffs allege misconduct based on the Board’s approval of new securities offerings
 24 despite their knowledge of the company’s financial condition. *Id.* The remaining claims,
 25 XV-XXII, are for breaches of fiduciary duties based on essentially the same conduct. *Id.*

26 **II. Legal Standard.**

27 **1. Pleading Standard.**

28 When analyzing a complaint for failure to state a claim to relief under

1 Rule 12(b)(6), the well-pled factual allegations are taken as true and construed in the light
 2 most favorable to the nonmoving party. *Cousins v. Lockyer*, 568 F.3d 1063, 1067 (9th
 3 Cir. 2009). To avoid a Rule 12(b)(6) dismissal, the complaint must plead enough facts to
 4 state a claim to relief that is plausible on its face. *Bell Atl. Corp. v. Twombly*, 550 U.S.
 5 544, 570 (2007). This plausibility standard “is not akin to a ‘probability requirement,’
 6 but it asks for more than a sheer possibility that a defendant has acted unlawfully.”
 7 *Ashcroft v. Iqbal*, 556 U.S. 662, 678 (quoting *Twombly*, 550 U.S. at 556).

8 “In alleging fraud or mistake, a party must state with particularity the
 9 circumstances constituting fraud or mistake.” Fed. R. Civ. P. 9(b). “To allege fraud with
 10 particularity, a [claimant] . . . must set forth an explanation as to why the statement or
 11 omission complained of was false or misleading.” *In re GlenFed, Inc. Sec. Litig.*, 42 F.3d
 12 1541, 1548 (9th Cir. 1994).

13 Securities claims must also meet the heightened pleading requirements of the
 14 Private Securities Litigation Reform Act (“PSLRA”). 15 U.S.C. § 78u-4(b)(1-2);
 15 *Tellabs, Inc. v. Makor Issues & Rights, Ltd.*, 551 U.S. 308, 320 (2007). When plaintiffs
 16 allege misleading statements or omissions, the PSLRA requires that the complaint
 17 “specify each statement alleged to have been misleading” and “the reason or reasons why
 18 the statement is misleading.” 15 U.S.C. § 78u-4(b)(1)(B). Plaintiffs must also “state
 19 with particularity facts giving rise to a strong inference that the defendant acted with the
 20 required state of mind.” 15 U.S.C. § 78u-4(b)(2)(A).

21 **2. Elements of 10b-5 Claim.**

22 To state a claim under Section 10(b) and Rule 10b-5, a plaintiff must plead: “(1) a
 23 material misrepresentation or omission by the defendant; (2) scienter; (3) a connection
 24 between the misrepresentation or omission and the purchase or sale of a security;
 25 (4) reliance upon the misrepresentation or omission; (5) economic loss; and (6) loss
 26 causation.” *Janus Capital Group, Inc.*, 131 S. Ct. 2296, 2301, n.3 (2011); *see also Dura*
 27 *Pharms., Inc. v. Broudo*, 544 U.S. 336, 341-42 (2005).

28

1 **III. Discussion**

2 **1. D&O Defendants.**

3 **A. Personal Jurisdiction.**

4 D&O Defendants argue that this Court does not have personal jurisdiction over
 5 them with respect to the state law claims. Doc. 105 at 4-9. The Court may assert pendent
 6 personal jurisdiction over state law claims that arise out of the same nucleus of operative
 7 facts as federal claims for which there is nationwide service of process. *See Action*
 8 *Embroidery Corp. v. Atlantic Embroidery, Inc.*, 368 F.3d 1174, 1180-81 (9th Cir. 2004)
 9 (pendent personal jurisdiction applies “where one or more federal claims for which there
 10 is nationwide personal jurisdiction are combined in the same suit with one or more state
 11 or federal claims for which there is not nationwide personal jurisdiction.”). In this case,
 12 the state law claims against the D&O Defendants arise out of a common nucleus of
 13 operative facts with the federal securities claims for which there is nationwide service of
 14 process. The Court therefore may exercise pendent personal jurisdiction over the D&O
 15 Defendants. *Id.*³

16 Plaintiffs have no federal securities claim against Defendant Ensign. As a result,
 17 pendent personal jurisdiction cannot apply to him. Doc. 114 at 3. In claim XXI, Ensign
 18 is charged with a breach of fiduciary duty. Because that claim arises from some of the
 19 same operative facts as other claims in the suit, it would be sufficient for supplemental
 20 subject matter jurisdiction under 28 U.S.C. 1337.

21 The Court can exercise personal jurisdiction over Defendant Ensign, however,
 22 only if he has minimum contacts with Arizona. *See Int'l Shoe Co. v. Washington*, 326
 23 U.S. 310, 316 (1945). A court must exercise either general or specific personal
 24 jurisdiction over a defendant. *See Helicopteros Nacionales de Colombia v. Hall*, 466

26 ³ D&O Defendants argue at some length in their motion to dismiss (Doc. 105) and
 27 in a prior motion (Doc. 79) that they lack minimum contacts with Arizona sufficient to
 28 create either general or specific personal jurisdiction. As these Defendants correctly
 acknowledge in their reply, however, minimum contacts are not required for pendent
 personal jurisdiction. Doc. 128 at 2-3; *Action Embroidery*, 368 F.3d at 1180-81.

1 U.S. 408, 414-15 nn.8-9 (1984); *Ziegler*, 64 F.3d at 473. Because Plaintiffs do not argue
2 for general jurisdiction over Ensign, the Court will consider whether Ensign's contacts
3 with Arizona are sufficient to support specific jurisdiction.

4 The Ninth Circuit applies a three-part test. Specific jurisdiction exists only if:
5 (1) the defendant purposefully availed himself of the privileges of conducting activities in
6 the forum, thereby invoking the benefits and protections of its laws, or purposely directs
7 conduct at the forum that has effects in the forum; (2) the claim arises out of the
8 defendant's forum-related activities; and (3) the exercise of jurisdiction is reasonable.
9 See, e.g., *Bancroft & Masters, Inc. v. Augusta Nat'l Inc.*, 223 F.3d 1082, 1086 (9th Cir.
10 2000) (citing *Cybersell, Inc. v. Cybersell, Inc.*, 130 F.3d 414, 417 (9th Cir. 1997)).

11 Plaintiffs argue that Ensign signed the registration documents for securities to be
12 sold in Arizona. Doc. 95 at 12-13. Because Plaintiffs' only specific claim against Ensign
13 relates to his participation in the alleged "stalking horse" bid and not in the registration
14 (Doc. 98 at 200-201), however, his signing of registration documents does not provide a
15 basis for specific jurisdiction – the claims against him do not arise out of signing of the
16 registration documents.

17 Plaintiffs also argue that Ensign facilitated the "stalking horse" bid with Defendant
18 Labine, who is an Arizona resident. Doc. 95 at 12-13. Because Labine is a citizen of
19 Arizona, Plaintiffs argue that it is reasonable to infer that Ensign had communications
20 and negotiations with Labine in Arizona as part of the bid. But the paragraphs cited by
21 Plaintiffs in support of this argument (¶¶ 129, 130, 144, 590, 594, 597, 601-601 of the
22 First Amended Complaint (Doc. 48)) say nothing about Ensign's role in negotiating the
23 bid and nothing about his activities in or communications with Arizona. Although it is
24 true that the Court must accept allegations in the complaint as true at the motion to
25 dismiss stage, and must draw reasonable inferences from those allegations in Plaintiffs'
26 favor, *Fiore v. Walden* 657 F.3d 838, 848 (9th Cir. 2011), the Court cannot base personal
27 jurisdiction on a complete absence of forum-contact allegations. Because Plaintiffs
28 identify no allegation regarding Ensign's contacts with Arizona in connection with the

1 bid, they have failed to allege a basis for personal jurisdiction over Ensign.⁴

2 **B. Adequacy of the 10b-5 Pleading.**

3 As a threshold matter, D&O Defendants argue that the complaint consists of
 4 impermissible “shotgun” or “puzzle” pleading that does not meet the PSLRA’s
 5 heightened pleading standard. *In re Metropolitan Sec. Litig.*, 532 F. Supp. 2d 1260, 1279
 6 (E.D. Wash. 2007); *In re Splash Tech. Holdings, Inc. Sec. Litig.*, 160 F. Supp. 2d 1059,
 7 1073-75 (N.D. Cal. 2001) (collecting cases). Puzzle pleading requires a defendant to
 8 “match up” the statements alleged in the complaint with the reasons why those statements
 9 are misleading, *In re Autodesk, Inc. Sec. Litig.*, 132 F. Supp. 2d 833, 842 (N.D. Cal.
 10 2000), while shotgun pleading incorporates each prior allegation into each subsequent
 11 claim for relief, making it difficult to determine which facts apply to which claims and
 12 defendants, *Wagner v. First Horizon Pharm. Corp.*, 464 F.3d 1273, 1279-1280 (11th Cir.
 13 2006). The Court agrees that the complaint is too long and unwieldy, but with respect to
 14 D&O Defendants, there are sufficient facts for the Court to evaluate the adequacy of the
 15 pleading. The Court will focus primarily on the factual allegations highlighted in
 16 Plaintiffs’ responses provided they are also found in the complaint.

17 Plaintiffs draw a distinction between the Director Defendants and the Officer
 18 Defendants. Doc. 114 at 1-2. Plaintiffs claim that the Director Defendants (including
 19 Curran, Shamblee, Lewis, Rapp, Hill, and Routt) approved securities offerings despite
 20 knowledge that the company was failing, and did not control Defendant McGrath who
 21 was the CEO and a fellow board member. *Id.* According to Plaintiffs, these actions are
 22 sufficient to support liability under Rule 10b-5. *Id.* With respect to the Officer
 23 Defendants (including Buettin and Thistleton), Plaintiffs allege that they made statements
 24 regarding the securities offerings, but omitted information about Domin-8’s financial
 25 circumstances in violation of Rule 10b-5. *Id.* Defendants argue that Plaintiffs have not

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 27 ⁴ The Court concludes below that the claim against Defendant Ensign is derivative
 28 and cannot be asserted by Plaintiffs. The Court nonetheless addresses the issue of
 personal jurisdiction because Plaintiffs are granted leave to amend and the Court’s view
 of the personal jurisdiction argument may be helpful to the parties.

1 pled a material misrepresentation or omission by the Officers and Directors, scienter,
 2 reliance on the misrepresentation or omission, and loss causation. *Dura Pharms.*, 544
 3 U.S. at 341-42.

4 **i. Material Misrepresentation or Omission.**

5 Rather than alleging a statement or omission by Directors, Plaintiffs claims are
 6 based on the Boards' approval of securities offerings when they knew that the company
 7 was in poor financial condition. Doc. 114 at 4-6. In *Central Bank of Denver, NA, v. First*
 8 *Interstate Bank of Denver, NA.*, 511 U.S. 164, 191 (1994), the Supreme Court held that
 9 there is no private right of action under § 10(b) for those who merely aid and abet a
 10 violation of the statute, but liability is still possible for defendants who do not make
 11 public statements under subsections (a) and (c) of Rule 10b-5. 17 C.F.R. § 240.10b-5(a-
 12 c). In *Stoneridge Investment Partners, LLC v. Scientific-Atlanta, Inc.*, 522 U.S. 148
 13 (2008), the Supreme Court held that “[c]onduct itself can be deceptive,” dispelling the
 14 notion that “there must be a specific oral or written statement before there could be
 15 liability under § 10(b) or Rule 10b-5.” *Id.* at 158. Plaintiffs argue that the Board’s
 16 conduct of approving the securities offerings is sufficient to plead a violation of Rule
 17 10b-5(a) and (c), which prohibit the use of “any device, scheme, or artifice to defraud” or
 18 the “engage[ment] in any act, practice, or course of business which operates or would
 19 operate as a fraud or deceit upon any person, in connection with the purchase or sale of
 20 any security.”

21 In the Ninth Circuit, liability based on Sections (a) and (c), referred to as “scheme
 22 liability,” may not be based on the same misrepresentation or omission as a Rule 10b-
 23 5(b) claim. *WPP Luxembourg Gamma Three Sarl v. Spot Runner, Inc.*, 655 F.3d 1039,
 24 1057 (9th Cir. 2011) (“A defendant may only be liable as part of a fraudulent scheme
 25 based upon misrepresentations and omissions under Rules 10b-5(a) or (c) when the
 26 scheme also encompasses conduct beyond those misrepresentations or omissions.”).
 27 Plaintiffs base their Rule 10b-5(b) claims against the company’s officers on alleged
 28 omissions related to Domin-8’s securities offerings, but argue that the Boards’ approvals

1 of the offerings constitutes conduct beyond the misrepresentations or omissions. They
2 argue that the Boards approved offerings knowing that the securities were “worthless.”
3 Doc. 114 at 7.

4 The facts that Plaintiffs allege to establish the Boards’ knowledge regarding the
5 value of the securities relate to meetings in which officers and directors were told that the
6 company would not qualify for venture capital without first filing for bankruptcy.
7 Doc. 98 ¶¶ 769, 785, 832. The Court must accept as true Plaintiffs’ allegations that the
8 company had contemplated bankruptcy and the allegation that the directors of the
9 company knew that the financial health of the company was poor. Even crediting those
10 assertions as true, however, the Court cannot find that Plaintiffs have alleged sufficient
11 conduct beyond the alleged misrepresentations to constitute a scheme within the meaning
12 of Rule 10b-5(a) and (c). Every company in poor financial condition does not fail, and it
13 cannot be said that approving a securities offering on behalf of a company in poor
14 financial condition is always and inevitably a fraudulent scheme. Struggling companies
15 may be rescued by a securities offering made with full disclosures. Investors may elect,
16 upon full disclosure, to invest in a struggling company that has a reasonable prospect of
17 survival and a significant upside if it does. Thus, the single fact that the company had
18 considered bankruptcy does not mean that approval of a securities offering by Defendants
19 was a fraudulent scheme. This is particularly true in light of Plaintiffs’ allegations that
20 Domin-8 later had a reasonable possibility of survival. Doc. 98 ¶ 819-821, 839-844.
21 Additional factual allegations are needed to suggest that approval of the securities
22 offering was part of a knowing scheme to defraud investors. On this record, Plaintiffs
23 have not alleged sufficient facts to support scheme liability.

24 In claim XII, Plaintiffs allege that Defendant Officers (Buettin and Thisleton)
25 made statements in connection with a securities offering and omitted the fact that the
26 company had contemplated bankruptcy. Doc. 114 at 16; Doc. 98 ¶ 1092-1094. Plaintiffs
27 point to statements in a letter to investors dated April 3, 2009, regarding the company’s
28 2008 securities offering. Doc. 114-4. In the letter, Defendants Buettin and Thistleton

1 acknowledged Domin-8's operating losses, but Plaintiffs allege that they put a positive
 2 spin on the information by claiming that the "operating losses are under control."
 3 Doc. 114 at 16-17. In the SAC, Plaintiffs quote additional language from the letter
 4 stating that the 2008 offering was "part of an overall solution as other alternatives would
 5 potentially negatively affect the character or terms of [investor's] investments, whether
 6 debt or equity, and would also potentially be dilutive to equity holders," and that the
 7 support of the investors was "definitely require[d] . . . in making the Offering a success."
 8 Doc. 98 ¶ 1092-1094. Plaintiffs argue that Defendant Officers should have "disclosed . . .
 9 in the correspondence that the company was actively considering the possibility of
 10 bankruptcy at the same time that it was trying to save the company by raising money
 11 through the offering." Doc. 114 at 17.

12 Rule 10b-5(b) makes it illegal to "omit to state a material fact necessary in order to
 13 make the statements made, in the light of the circumstances under which they were made,
 14 not misleading." Defendants claim that Plaintiffs fail to show that the statements were
 15 misleading. The PSLRA requires that the "complaint . . . specify each statement alleged
 16 to have been misleading" and "the reason or reasons why the statement is misleading."
 17 15 U.S.C. § 78u-4(b)(1)(B); Doc. 128 at 7. Plaintiffs point to the specific absence of any
 18 mention of bankruptcy in the letter; Defendants point to several cautionary statements in
 19 the letter. Doc. 114 at 16. Given these competing factual arguments, whether the letter
 20 as a whole is misleading amounts to a factual dispute that cannot be resolved at the
 21 motion to dismiss stage. The Court will deny the motion to dismiss with regard to claim
 22 XII against Officer Defendants.

23 **ii. Scienter.**

24 For Rule 10b-5 claims, the Supreme Court has defined scienter as the "intent to
 25 deceive, manipulate or defraud." *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 193 n.12
 26 (1976). The Ninth Circuit requires that "intent to deceive" be alleged "in great detail,
 27 [by] facts that constitute strong circumstantial evidence of deliberately reckless or
 28 conscious misconduct." *Silicon Graphics Inc. Securities Litig.*, 183 F.3d 970, 974 (9th

1 Cir. 1999). A complaint will survive a motion to dismiss “only if a reasonable person
 2 would deem the inference of scienter cogent and at least as compelling as any opposing
 3 inference one could draw from the facts alleged.” *Tellabs*, 551 U.S. at 324. A court must
 4 first determine whether any single allegation is “sufficient to create a strong inference of
 5 scienter; [and] second, if no individual allegation is sufficient,” the court must conduct “a
 6 ‘holistic’ review of the same allegations to determine whether the insufficient allegations
 7 combine to create a strong inference of intentional conduct or deliberate recklessness.”
 8 *N.M State Inv. Council v. Ernst & Young LLP*, 641 F.3d 1089, 1095 (9th Cir. 2011).

9 Plaintiffs’ allegations of scienter for both the Officers and Directors are based on
 10 the “reckless conduct” of making securities offerings and failing to disclose the poor
 11 financial condition of the company. By “reckless,” Plaintiffs seem to mean that the
 12 directors and officers engaged in conduct that entailed an unjustifiably high risk of
 13 bankrupting the company because they personally held securities and options to purchase
 14 securities that would be worth more if the company survived long enough to go public.
 15 Doc. 114 at 8. This belief is reinforced, Plaintiffs allege, by the Board’s decision to swap
 16 preferred securities for common stock, an exchange that placed their own shares on the
 17 same level as earlier investors’ should the company go public. *Id.*

18 With respect to the theory that the Officers and Directors recklessly drove the
 19 company toward bankruptcy, Defendants’ conduct could be explained as the actions of
 20 incompetent or over-zealous managers. In *Spot Runner*, the Ninth Circuit determined
 21 that scienter was adequately pled when the plaintiffs alleged that a company’s founders
 22 continued to solicit investment in the company while they sold their own shares despite
 23 an agreement to inform the investors of any such sales. 655 F.3d at 1054. There, the
 24 inference regarding the defendants’ intent to deceive was reinforced by the simultaneous
 25 selling of their own shares and marketing new shares to the public. In this case, Plaintiffs
 26 do not allege that Defendants were selling their own stock or somehow deriving financial
 27 benefit at stockholder expense while simultaneously endorsing the company’s offering.
 28 It is true that they stood to gain from the company’s continued survival, but that is

1 virtually always the case, and is true of Plaintiff shareholders as well. In other words,
2 Plaintiffs theory of scienter is weakened by their failure to explain how the interests of
3 the Directors and Officers diverged from the interests of the shareholders. Defendants
4 note that improving the financial health of a company is often a principal object of a
5 securities offering (Doc. 128 at 7), and Plaintiffs appear to concede in their response that
6 the Defendants were “trying to save the company.” Doc. 114 at 17. Plaintiffs’ theory of
7 scienter seems less compelling than the counter-inference that Defendant Directors were
8 trying to save the company. *Tellabs*, 551 U.S. at 324.

9 With respect to the Officer Defendants, Plaintiffs plead additional facts that
10 buttress their theory of scienter. They argue that the Officer Defendants refused an
11 infusion of cash that could have saved the company, choosing instead to file for
12 bankruptcy. Doc. 98 ¶ 839-844. This secondary theory is that after recklessly failing to
13 disclose the extent of the company’s problems when making securities offerings in an
14 attempt to avoid bankruptcy, the officers changed tactics and chose to file for bankruptcy
15 when it was not inevitable but was in their personal best interests. Plaintiffs allege that
16 the Officers solicited a stalking horse bid for the company from friendly investors that
17 would have allowed the Officers to maintain high positions within the company when it
18 emerged from bankruptcy. Doc. 98 ¶¶ 134-136, 836-838, 855-859. At this stage in the
19 pleadings, Plaintiffs have alleged sufficient facts to support a theory that Defendant
20 Officers acted with scienter. *Tellabs*, 551 U.S. at 324.

21 **C. Adequacy of Section 20(a) Claim.**

22 Section 20(a) allows for vicarious liability of control persons when someone
23 within their control violates another section of the Exchange Act. Plaintiffs allege that
24 D&O Defendants are liable under this section because the CEO, McGrath, violated
25 Section 10(b) and the Officers and Directors failed to stop him. While the Directors’
26 status as “control persons” is in dispute, the Court need not reach that question as it will
27 dismiss all claims against McGrath. Because there is no underlying 10(b) violation, this
28 claim must be dismissed.

D. Adequacy of Section 14(e) Claim.

Claim XIV alleges a violation of Section 14(e) of the Exchange Act. An adequate pleading under Section 14(e) requires allegations of misstatements or omissions of material facts in connection with a tender offer. *Plaine v. McCabe*, 797 F.2d 713, 721 (9th Cir. 1986). This claim is brought against the 2006 Board and McGrath. As noted above, Plaintiffs do not allege facts showing any misstatements or omissions were made by Defendant Directors. Because they have not pled any misstatements or omissions, the Court will dismiss this claim with respect to the 2006 Board.

E. State Law Claims.

i. Pendent Personal Jurisdiction.

Because the Court has dismissed the federal claims against the Director Defendants, it will decline to exercise pendent personal jurisdiction over the state law claims asserted against them. *See Action Embroidery*, 368 F.3d at 1180-81 (“we leave it to the discretion of [the district court] to decide whether to retain or dismiss the pendent state-law claims”); *Toensing v. Brown*, 528 F.2d 69, 72 (9th Cir. 1975) (“upon dismissal of the federal claim before trial, a proper exercise of discretion required dismissal of the pendent state law claim”); *see also D’Addario v. Geller*, 264 F. Supp. 2d 367, 387-88 (E.D. Va. 2003) (holding that the state law claims against a particular defendant should be dismissed when the federal claims against that defendant were dismissed unless an independent basis for personal jurisdiction exists). Therefore, claims XV, XVI, XVII, and XX are dismissed as against the Defendant Boards.

ii. Standing

Two state law claims, XVIII and XXI, were brought against Officer Defendants and therefore the exercise of pendent personal jurisdiction is appropriate. D&O Defendants move to dismiss these claims on the grounds that they are derivative in nature and Plaintiffs lack standing to bring claims on behalf of the company.

Domin-8 was incorporated in Delaware and both parties agree that Delaware law governs the distinction between direct and derivative claims. The question was reduced

1 to a two part inquiry in *Tooley v. Donaldson, Lufkin & Jenerette, Inc.* 845 A.2d 1031,
 2 1035 (Del. Ch. 2004): (1) who suffered the alleged harm – the corporation or the suing
 3 stockholder individually, and (2) who would receive the benefit of the recovery or other
 4 remedy? The court then simplified the analysis, explaining that a claim is direct if “the
 5 plaintiff demonstrate[s] that he or she can prevail without showing an injury to the
 6 corporation.” *Id.* (quoting *Agostino v. Hicks*, 845 A.2d 1110, 1118 (Del. Ch. 2004)). If
 7 the claim is derivative in nature, Defendants argue that only the liquidating trustee named
 8 in Domin-8’s approved bankruptcy plan has power to bring the claim. Doc. 105 at 25
 9 (citing Domin-8 Amended Bankruptcy Plan, Case No. 3:09-bk-35789 (BK Doc. 550) at
 10 7-8, 16-18, 36, 43-44).

11 The factual allegations set forth in claims XVIII relate to the 2008 Series D Senior
 12 Subordinated Debentures and the alleged omissions of Officers Buettin and Thistleton in
 13 statements about that offering. Doc. 98 at 195. It alleges that as a result of Buettin and
 14 Thistleton “selectively communicating information about the Company’s finances,” the
 15 investors did not know that the company “had been contemplating bankruptcy.” *Id.*
 16 ¶¶ 1172, 1174. Had they known, Plaintiffs allege, they would not have invested in the
 17 2008 Series D Senior Subordinated Debentures. *Id.* ¶ 1174. In the next paragraph,
 18 however, Plaintiffs allege that the offering increased the overall debt of the company and
 19 led to the company’s bankruptcy. *Id.* ¶ 1175. This allegation accords with the general
 20 statement from the complaint that Plaintiffs’ injuries resulted from Domin-8’s
 21 bankruptcy. Doc. 98 ¶ 864. Because Plaintiffs’ only alleged injuries result from the
 22 company’s bankruptcy, and the bankruptcy clearly injured the company as well as the
 23 investors, Plaintiffs have not demonstrated that they can prevail without showing an
 24 injury to the corporation. Their claims are therefore derivative, not direct. *Agostino*,
 25 845 A.2d at 1118.

26 In claim XXI Plaintiffs allege a breach of “fiduciary duty for disloyalty and bad
 27 faith” against Officers Buettin, Thisleton, and Ensign. Doc. 98 at 200. The factual
 28 allegations relate to the manner in which the officers negotiated the friendly bankruptcy

1 bid. Doc. 98 ¶ 1203. Plaintiffs allege that the Officers were personally interested in the
2 negotiations and that their “actions caused injury to all debt and equity holders in the
3 Company.” Doc. 98 ¶ 1205. This claim, which suggests that the bankruptcy was part of
4 a plan to secure the Officers high positions in the post-bankruptcy entity, also clearly
5 alleges an injury to the corporation. Because Plaintiffs cannot show harm to themselves
6 under this claim without also showing harm to the company, the claim is derivative.

7 Plaintiffs do not contest Defendant’s argument that Domin-8’s derivative claims
8 are under the control of the liquidation trustee. Because claims XVIII and XXI are
9 derivative in nature, the Court finds that Plaintiffs do not have standing to bring them on
10 behalf of Domin-8.

11 **2. Defendant McGrath.**

12 Defendant McGrath is named in claims I-V, XI, XIII, and XX as a member of
13 various Boards, in claims VI-X, and XIX in his individual capacity as Domin-8’s CEO,
14 and in claims XIV-XVII in both capacities. With respect to the securities fraud claims,
15 Defendant moves to dismiss the complaint for failure to state a claim. The pleading
16 standards are the same as those set forth above.

17 **A. Adequacy of the 10b-5 Pleading.**

18 **i. Misleading Statement or Omission.**

19 With respect to the claims against McGrath, the concerns about shotgun or puzzle
20 pleading are much more significant. He is named as a defendant on nearly every claim in
21 the complaint, and the specific statements or omissions upon which each claim against
22 him is based are nearly impossible to discern.

23 In their response, Plaintiffs seem to argue that because they have pled facts
24 alleging that McGrath was in possession of information he did not disclose, his omissions
25 make him liable. Doc. 113 at 5. They claim to have “identifie[d] in excruciating detail
26 each and every statement and projection . . . that McGrath made in order to establish a
27 framework for what he actually knew when he omitted material information in
28 connection with the securities sold to Plaintiffs.” Doc. 113 at 3 (emphasis in original).

1 Using McGrath's statements to establish what he knew could be helpful, but the SAC
 2 does not identify the particular statements that were misleading as a result of omitted
 3 information. Rule 10b-5(b) makes it illegal to "omit to state a material fact necessary in
 4 order to make the statements made, in light of the circumstances under which they were
 5 made, not misleading." Plaintiffs fail to direct the Court to specific statements so that it
 6 can evaluate the circumstances under which the statements were made.

7 Where Plaintiffs finally approach the required level of specificity and flag actual
 8 statements that they allege were made misleading by material omissions, they do so only
 9 "by illustration." Doc. 113 at 11. That illustration is the kind of specificity with which
 10 all statements must be identified. Unfortunately, the particular illustration quotes specific
 11 language from an alleged McGrath communication, but provides no citation to where that
 12 language is ever mentioned in the SAC. Doc. 113 at 11. Plaintiffs specifically reference
 13 McGrath's projections (Doc. 113 at 17), but, in response to Defendant's arguments that
 14 unrealized projections cannot be the basis of a securities claim, Plaintiffs state that their
 15 claims "sound primarily in the nature of omissions and are not based directly on the
 16 projections set forth in the general allegations of the SAC." Doc. 113 at 7. Basing their
 17 claims in omissions does not excuse Plaintiffs from the PSLRA's requirement that
 18 allegedly fraudulent statements be pled with specificity. 15 U.S.C. § 78u-4(b)(1)(B).

19 While the Court was able to find enough information to rule on the claims against
 20 the D&O Defendants, Plaintiffs simply do not provide sufficient citations to the 1,216
 21 paragraphs in the SAC to enable the Court to evaluate the claims made against McGrath.
 22 The Court is left to "connect-the dots," an impractical and unnecessarily burdensome task
 23 in a complaint of this length. *In re PetSmart, Inc. Sec. Litig.*, 61 F. Supp. 2d 982, 988 (D.
 24 Ariz. 1999). Plaintiffs, not the Court, bear the burden of demonstrating the sufficiency of
 25 their complaint. The Court will dismiss all claims against McGrath.

26 **B. Supplemental Jurisdiction over State Law Claims.**

27 Having dismissed the federal securities claims against Defendant McGrath, the
 28 Court declines to exercise supplemental jurisdiction over the state law claims against

1 him. *See* 28 U.S.C. § 1367(c)(3).

2 **3. Defendant Labine.**

3 The only claim against Defendant Labine and the corporate defendants is claim
 4 XXII for aiding and abetting breach of fiduciary duty. Personal jurisdiction over Labine
 5 is not contested as he is an Arizona resident. Doc. 98 ¶ 116. The Court may exercise
 6 supplemental jurisdiction over the claim because it is transactionally related to the
 7 securities claim against Defendant Officers that survived the motion to dismiss. 28
 8 U.S.C. § 1367(a). However, because this claim, like several of the other fiduciary claims
 9 is derivative in nature, Plaintiffs do not have standing to bring it on behalf of the
 10 company.

11 Plaintiffs argue in their response that the Directors and Officers violated 8 Del. C.
 12 § 144(a)(2) by failing to disclose that they were interested when they negotiated the
 13 stalking horse bid. Doc. 112 at 3-4. They then cite an unpublished opinion of the
 14 Delaware Chancery Court that held that when corporate officers violate the Delaware
 15 General Corporate Law they violate the rights of the shareholders, not the corporation.
 16 *Grayson v. Imagination Station, Inc.*, No. 5051, 2010 WL 3221951 at *5 (Del. Ch. 2010).
 17 8 Del. C. § 144(a)(2) generally provides that interested transactions will not be voided so
 18 long as there is disclosure to shareholders who are entitled to vote on the transaction. It
 19 does not appear that Plaintiffs have pled facts that show a violation of this section.

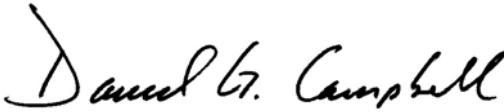
20 In the SAC, Plaintiffs claim that Labine and the corporate entities participated in a
 21 breach of fiduciary duties on the part of Domin-8 Officers and Boards by helping to sell
 22 securities and by “attempting to purchase the assets of the Company if it agreed to file
 23 bankruptcy, which it did.” *Id.* ¶¶ 1211-12. Plaintiffs’ alleged harm is again traceable to
 24 the actions of the company’s officers that led to bankruptcy. Because the bankruptcy
 25 caused harm to the company as well as the investors, this claim is derivative and only
 26 Domin-8’s liquidation trustee has standing to bring it. *Agostino*, 845 A.2d at 1118.
 27 Therefore, this claim must also be dismissed.

28

1 **IT IS ORDERED:**

- 2 1. D&O Defendants' Motion to Dismiss (Doc. 105) is **granted in part and**
3 **denied in part** as set forth above
- 4 2. Defendant McGrath's Motion to Dismiss (Doc. 101) is **granted**.
- 5 3. Defendant Labine's Motion to Dismiss (Doc. 103) is **granted**.
- 6 4. All claims, with the exception of claim XII, in Plaintiffs' Second Amended
7 Complaint (Doc. 98) are **dismissed** with leave to amend.
- 8 5. Plaintiffs shall file a Third Amended Complaint by **November 16, 2012**.
9 Plaintiffs are cautioned that this is the final opportunity the Court will give
10 them to amend the complaint.

11 Dated this 1st day of November, 2012.

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David G. Campbell
16 United States District Judge
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